

# the light report



**November-December 2002**

**Volume 6; Number 3**

## **Superintendent's Summary: City Light Audit and Work Program**

City Light is moving ahead to implement the recommendations made in the recent utility audit.

We have already reviewed a preliminary work plan with the full City Council. The audit contained 39 recommendations, and we will be embarking on several initiatives simultaneously. This will be a strenuous period for the utility and the Council, but the work is extremely important.

There are several tasks that we see as priorities.

We will begin immediately to update our strategic business plan. This involves comprehensive documentation of current policy, review of previous strategic plans, and an inventory of strategic issues facing the utility. We will conduct a strategic planning workshop in January or February. We expect to complete our strategic business plan in the spring.

Also this month we will begin a complete review of City Light's debt management and financial policies, practices and conditions. We will review the budgets and forecasts for both our capital and operating programs. We will engage the Council early next year in a discussion of rates forecasting. A comprehensive debt management strategy – including goals, objectives and performance metrics – should be in place by next fall.

We already begun documenting our current risk/power management policies and updating our risk management manual. We will revisit the Deloitte & Touche audit soon and produce a status report and assessment of its recommendations.

This is just a small sample of the work ahead of us. We look forward in the coming weeks to detailed discussions of the work program with our elected officials.



## **The Periscope: Weather Watch**

You've no doubt read that October was the driest month in history and until very recently, November has been dry as well. As one of the most hydro dependent utilities, we are keeping a close eye on the weather.

We plan our hydro system around an October through September water year. October, November and December are key months for precipitation on the Skagit. On average, about 35 inches of precipitation falls above our Skagit dams during those three months alone. The Ross Dam complex drains 1000 square miles and 35 inches of precipitation translates into an enormous amount of electricity.

During October, the thirty year average rainfall would be about seven and a half inches. This October, we had just a trace. November is extremely important, normally producing over 14 inches. As of November 15, we had just under four inches. December is another big producer, bringing in about 12 inches during the month. (see charts on page 4)

Normally, our dams on the Skagit and the Pend Oreille Riv-

ers generate more than 70% of the 10,000,000 megawatt hours of electricity our customers require. Last year's drought had our power production cut in half.

This year, the long term forecast is for a "minor" El Niño. This means relatively wetter weather to the south and drier weather in our neck of the woods. We expect a dry winter, but not as dry as we are seeing so far.

Things can and do change radically on the Skagit. In 1977, the worst drought year ever, heavy rain and snow late in the Spring of 1978 washed out what could have been a terrible year. The 95-96 drought started with a very normal fall and little else afterward. It's not unusual to have several days of rainfall at two inches a day.

The combination of rainfall and snowpack also present a number of variables to us. Sometimes, we've developed a strong snowpack only to have it disappear in a warm, chinook rainfall that washes it off the hills.

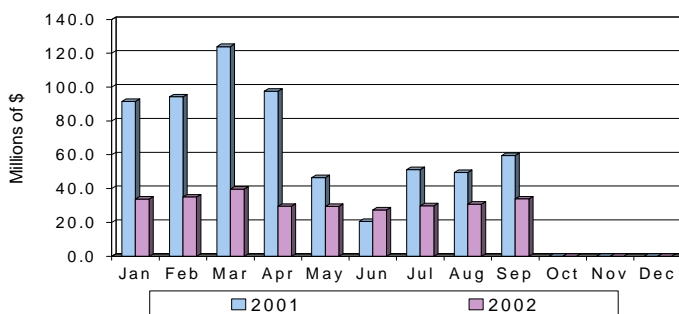
We've never been better positioned for a dry year than we are to-

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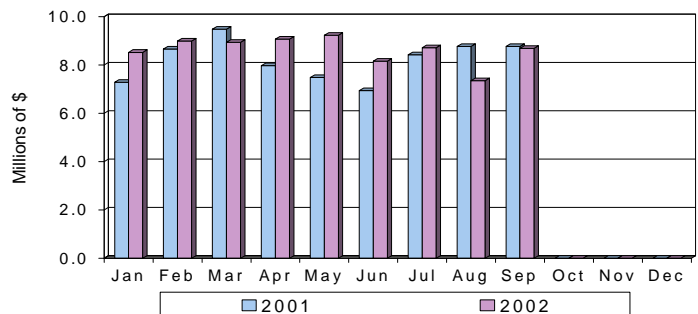
## Actual Financial Performance Year-to Date through September 2002

Summary Financial Statement (Amounts in Millions of Dollars)			2002 minus 2001	Reasons for Major Variances 9 Months 2002 vs. 9 Months 2001
2002	2001			
<b>Operating Revenues</b>				
Retail Power Revenues	\$432.9	\$361.6	\$71.3	<ul style="list-style-type: none"> <li>Retail Power Revenues increased by \$71.3 million, or 19.7%, because of higher rates. System average rates rose 18.0%, 9.3% and 10.3% in March, July and October 2001, respectively. Network rates increased another 0.5% in March 2002, followed by a system average rate decrease of 1.1% in April 2002. Billed MWh totalled 6.8 million MWh, up 0.6% from a year ago.</li> </ul>
Wholesale Power Revenues	\$102.1	\$94.4	\$7.6	<ul style="list-style-type: none"> <li>Wholesale Power Revenues increased \$14.8 million, despite lower market prices, because of substantially higher volume. Short term sales totalled 4.0 million MWh at an average price of \$22.60/MWh vs. 0.3 million MWh at \$210.14/MWh a year earlier. Basis sales, which were reclassified from Transmission Revenue to Wholesale Power Revenue in September, fell \$5.9 million.</li> </ul>
Transmission and Other	\$10.1	\$5.2	\$4.9	<ul style="list-style-type: none"> <li>Power Exchanges and Other Power Revenues fell \$7.2 million because of an \$11.3 million decline in the value of exchange energy delivered to Idaho Power and Northern California Power Authority. Revenue from wind integration and exchange services provided to PacificCorp Power Marketing, under contracts effective January 2002, totalled \$2.2 million.</li> </ul>
<b>Total</b>	<b>\$545.0</b>	<b>\$461.3</b>	<b>\$83.8</b>	<ul style="list-style-type: none"> <li>Transmission Revenues decreased \$0.6 million. The Department used more transmission capacity to deliver BPA power to the service area, leaving less available for sale.</li> </ul>
<b>Operating Expenses</b>				
Power & Transmission	\$289.6	\$634.6	(\$345.0)	<ul style="list-style-type: none"> <li>Other Revenues increased \$5.6 million because billings recorded as offsets to expenses and customer late payment fees recorded as non-operating revenues in prior years were reclassified as operating revenues in 2002.</li> </ul>
Other O&M	\$77.7	\$73.8	\$3.9	<ul style="list-style-type: none"> <li>Power Expenses fell \$353.1 million and Transmission Expenses rose \$8.1 million. See graph below for details.</li> </ul>
Taxes	\$46.6	\$37.8	\$8.8	<ul style="list-style-type: none"> <li>Nonpower O&amp;M Expenses increased \$3.9 million. See graph below for details.</li> </ul>
Depreciation & Amortization	\$52.6	\$42.3	\$10.2	<ul style="list-style-type: none"> <li>Taxes rose \$8.8 million, primarily due to the higher revenue base. A 2001 refund from the IRS of arbitrage rebate overpayments in prior years which reduced 2001 taxes by \$1.2 million also contributed to the increase in 2002.</li> </ul>
<b>Total</b>	<b>\$466.4</b>	<b>\$788.5</b>	<b>(\$322.1)</b>	<ul style="list-style-type: none"> <li>Depreciation rose \$10.2 million. \$7.2 million of the increase reflects additional plant placed in service in 2001. Depreciation rose another \$3.0 million because contributions in aid of construction (CIAC) are no longer deferred and amortized.</li> </ul>
<b>NET OPERATING INCOME</b>	<b>\$78.6</b>	<b>(\$327.3)</b>	<b>\$405.9</b>	<ul style="list-style-type: none"> <li>Investment Earnings were \$1.8 million lower. In 2001, interest on funds borrowed from the City cash pool offset interest income, whereas it was recorded as interest expense in 2002, which increased interest income by \$1.0 million. Earnings on cash and investments from 2001 borrowing declined \$2.4 million, as these balances were expended in 2001. Flat fee penalties on late customer payments were reclassified as operating revenue effective September, reducing investment earnings by \$0.8 million. Interest charges on late customer payments, \$0.6 million through September, are still recorded as investment earnings but will also be reclassified as operating revenue later this year.</li> </ul>
<b>Other Deductions, Net</b>				
Investment Income	\$7.9	\$9.7	(\$1.8)	<ul style="list-style-type: none"> <li>Debt Expense increased \$9.9 million because of \$6.7 million higher expense for the 2001 parity bond issue, \$2.2 million for the RAN and \$2.3 million for the interfund loan executed in December 2001. Interest expense on other parity issues fell \$2.6 million, due to redemptions and refundings, and variable rate bond expense decreased \$1.6 million due to declining interest rates. Interest during construction, which offsets interest expense, decreased \$2.4 million, reflecting reduced expenditures on capital projects.</li> </ul>
Other Income (Expense), Net	\$0.0	(\$0.2)	\$0.2	<ul style="list-style-type: none"> <li>Net Income earned through September totalled \$30.9 million, a marked turnaround from the \$371.4 million net loss incurred during the same period a year ago. This included \$75.0 million of power expenses deferred from 2001, without which net income would have been \$105.9 million.</li> </ul>
Interest Expense	(\$63.6)	(\$53.6)	(\$9.9)	
Contrib. in Aid of Construction	\$7.7	\$0.0	\$7.7	
Grants and Transfers	\$0.2	\$0.0	\$0.2	
<b>NET INCOME (LOSS)</b>	<b>\$30.9</b>	<b>(\$371.4)</b>	<b>\$402.2</b>	

### Power & Transmission Expenses



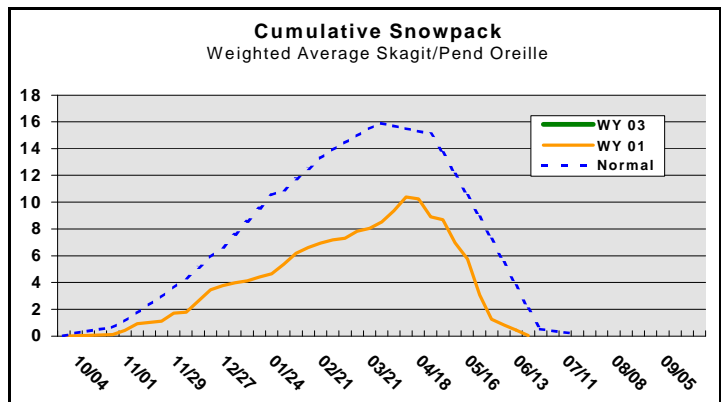
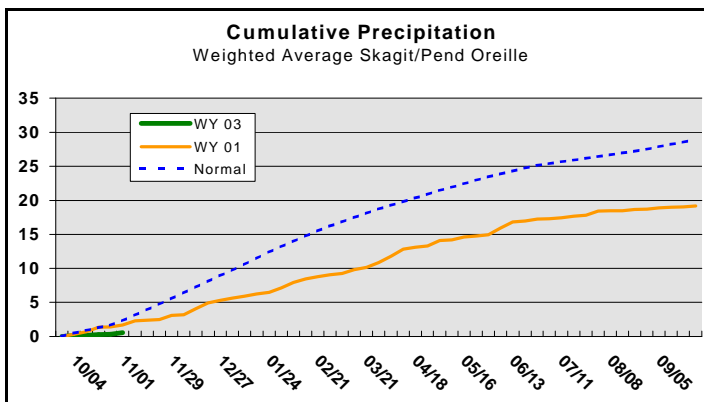
### Non-Power O&M Expenses



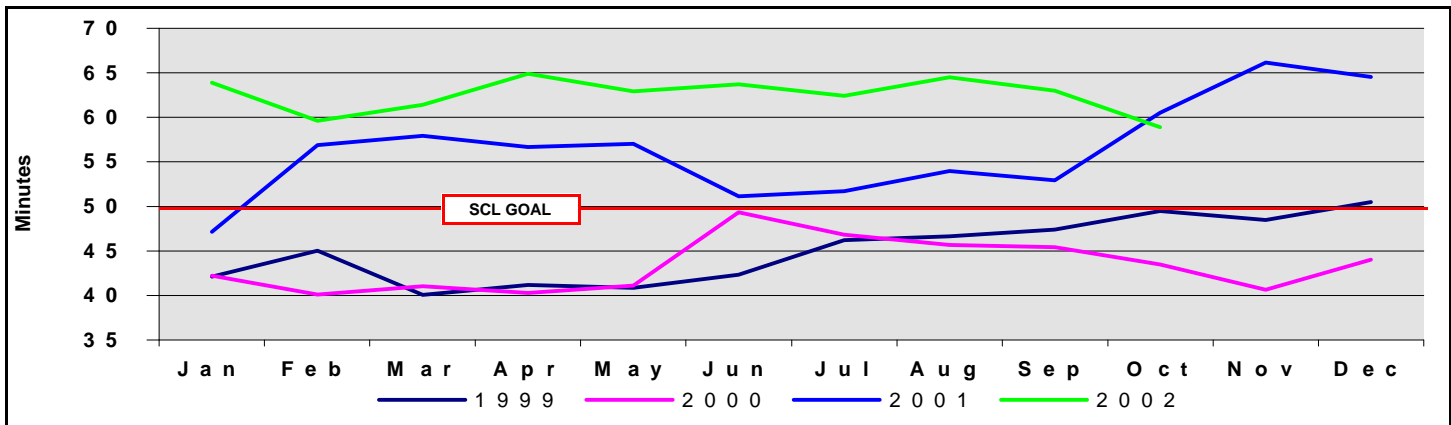
**Power and Transmission expenses** include costs of production, purchased power, power marketing, system control, owned transmission and wheeling. Power and transmission expenses through September were \$345.0 million lower than a year ago, mainly on account of a \$427.9 million drop in short-term wholesale purchases. The Department did not require as much short-term power because of increased generation, due to improved water conditions, and increased purchases through new long-term contracts. Both the volume and average price of short-term purchases fell dramatically. The Department purchased 468,492 MWh at \$20.81 per MWh, down from 2,138,485 MWh purchased at \$236.57 per MWh during the first nine months of 2001. Long-term purchased power expenses rose \$67.6 million because of a \$70.1 million increase in purchases from BPA and \$20.8 million in purchases from Klamath Falls, including \$7.1 million for the associated gas price swap. Expenses for energy exchanges decreased \$19.8 million because sizeable exchanges with BPA and the California ISO in 2001 were not repeated in 2002. Renewable resources expenses totaled \$5.6 million for power purchased from the State Line Wind Project. Generation expenses rose \$1.6 million, mainly for preventive maintenance at Ross and Boundary and higher FERC administrative fees. Total generation, at 5,835,719 MWh, was up 108.6% from 2,797,438 MWh a year earlier. Transmission expenses rose \$8.1 million. BPA's reservation fee for transmission of additional Slice power was \$7.3 million and wheeling for Boundary power increased \$2.2 million. Expenses for BPA transmission losses declined by \$1.3 million, because these are currently being physically returned rather than compensated for monetarily.

**Non-Power O&M expenses** include distribution, conservation, customer service, administrative and general expenses. Non-power O&M expenses increased \$3.9 million due to higher distribution, conservation, administrative and general expenses. Distributions expenses grew \$1.3 million due to higher outlays for overhead and underground line maintenance, streetlighting, technical metering, load dispatching and records maintenance. This increase also reflects the reclassification in 2002 of billings for services on customer premises from expense offsets to revenues. Conservation expenses increased \$1.1 million as higher deferred costs were amortized. Administrative and general expenses increased \$1.9 million because of higher salaries, employee pensions and benefits, and insurance claims related to toxic cleanup, and a reduced allocation of A&G expenses to CIP projects. These increases were partially offset by a \$0.9 million rebate of service charges from the City General fund. Customer service expenses declined \$0.5 million, primarily because \$1.1 million of customer information expense for advertising to encourage reduced consumption in 2001 was not repeated this year.

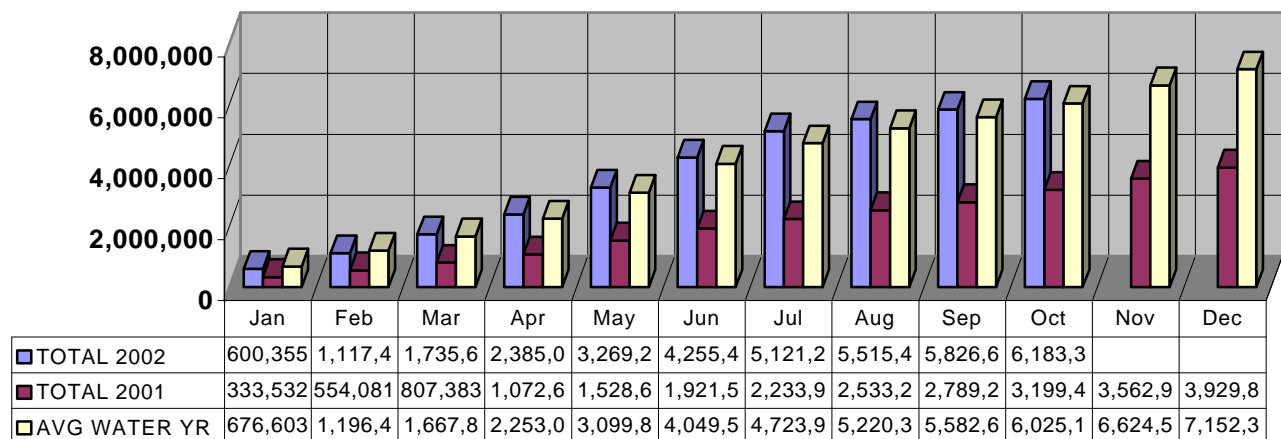
## Standard Departmental Monitoring and Performance

Water Resources as of Nov.1, 2002

The 2003 water year (green line) began October 1, and is off to a very dry start, lagging behind even the record drought year of 2001 (tan line). The National Weather Service reports that we are in another El Niño cycle, but not as strong as the 1997-98 event. They predict a warmer and much dryer fall, with increased likelihood of precipitation in early 2003.

Customer Outage Minutes

Tree-related outages and equipment failures have driven up the System Average Interruption Duration Index (SAIDI) in 2001 and 2002. The 12-month rolling average SAIDI improved by about 4 minutes over the figure published last month. This is due to fewer and less significant incidents impacting the overhead system this October compared to last year.

Cumulative Net MWH Generation

Through **October** 2002, SCL's cumulative net generation is tracking at **three** percent greater than average and almost double the drought-influenced 2001 figure. The inverse of this relationship is reflected in our generation costs for this period: due primarily to SCL's cost-containment efforts, this year's average production cost is **\$3.87/MWh**, compared to **\$3.98/MWh** in an average water year and **\$7.04/MWh** in 2001. For comparison, the averaged Dow-Jones Mid-Columbia Index price for January through October is **\$19.06/MWh**.

day. Even under conditions somewhat worse than last year, we are positioned to meet our load with electricity that we own or control in every month.

While we can meet our load, the poor water conditions will affect the volume of our surplus sales of electricity. Low water conditions over a long period of time also can affect the salmon runs we manage. While we have minimum flows, the higher water temperatures and lower water levels are not the best for adult fish returning or juvenile fish going down river.

For in-depth information on climate, El Niño and the winter outlook, log on to the NOAA Seattle Climate Prediction Page at <http://www.wrh.noaa.gov/seattle/>.

## Bits and Pieces: News and Notes from City Light and the Utility Industry

- There will not be agreement between the conferees regarding the Congress on the Electricity Restructuring portion of the Energy Bill. It is likely that restructuring will come up again later.
- On November 15, City Light submitted general comments to FERC on its proposed standard market design rules. More detailed comments will be submitted in January. Our general comments were consistent with the issues the alliance of Northwest and other utilities fighting this FERC initiative have been articulating. Our key concern involves FERC's finding that vertically-integrated utilities (i.e., those that own generation, transmission, and distribution) automatically practice "undue discrimination" under federal law, a finding that gives the agency the authority to override state and local rules and restructure regional energy markets. We disagreed with this conclusion - whether it applies to us, or BPA, or not - and with the very intricate, expensive, and potentially risky energy and transmission markets FERC proposes for the Northwest.
- A group of utilities have been negotiating settlement of a lawsuit filed against BPA by some of the publics (not Seattle) for how generous it was to the privates in the 2002-11 power contracts. SCL has supported the concept of the settlement proposal, which would allocate BPA power to public utilities and a little to the aluminum direct service industries. It would also establish a formula for future monetary payments to the private utilities, instead of BPA buying power for them. Publics would be responsible for any cost of load growth beyond the federal output, unless they took that responsibility directly by freezing their amount of federal power. SCL does not support trading our current contract to a freeze of our federal power at 396 aMW (Slice). Our current mix is better, as it includes a very low-cost block during the fall and winter. The final negotiations of this settlement are producing some concerns and perhaps some improvements. SCL did not support a reduction in current entitlements, but we do support more choice between slice and block arrangements. Following BPA review, SCL will conduct a final analysis for review with City elected officials. The trade off between having some additional load growth as our current contract provides until 2011 and a longer-term agreement as the settlement provides is the key issue.
- The final proof of claim documentation for amounts owed to us by the bankrupt Enron was officially filed by legal counsel on October 15. The total claim amount was \$6,108,745.61.
- SCL completed the purchase of the Failla Property, a 110 acre parcel located on the Sauk River near Darrington. This property provides exceptional habitat for Chinook salmon, steelhead trout, bull trout, and other fish species, and possesses approximately two miles of mainstream river and side channel habitat. This property was acquired through SCL's ESA Early Action Program. Matching funding was provided through a grant awarded by the National Fish and Wildlife Foundation. The Skagit System Cooperative will be providing additional funding to restore side channels and sloughs on this property presently isolated from the mainstream river.
- A television production company filmed a segment on SCL's bull trout research in the Ross Lake drainage on September 15th. Ed Connor was interviewed for a new program, "Inside America's National Parks." The focused on SCL's environmental stewardship, our successful research partnership with the National Park Service and BC Parks, and interesting information on the biology of bull trout. The program will be televised nationally later this year.
- Bonneville customers have concluded a settlement for a transmission rate increase that will go into effect in 2003 and carry through 2005. The increase is expected to be 1.5 percent for Seattle or about \$300,000/ year. This is about half of the amount Bonneville originally forecast. Seattle remains in negotiations with BPA over a transmission congestion relief proposal related to this settlement that could result in temporary curtailments of transmission availability in central Puget Sound in some extreme conditions.

## UPCOMING COUNCIL AGENDA ITEMS

### *Dec. 5 Energy and Environmental Policy Committee:*

- Greenhouse Gas Mitigation Contract Ordinance
- Financial Status Briefing
- Short-term Financing Alternatives Discussion
- FERC Standard Market Design Proposal: comments and discussion
- Transmission Rate Case Discussion
- BPA Power Rate Increase Process Discussion/Briefing
- Wildlife Lands Purchase Ordinances